NOTE 12 – BONDS AND NOTES PAYABLE – PRIMARY GOVERNMENT

A. General Information

General Obligation Bonds and Notes

Article 9, Section 15, of the State Constitution authorizes general obligation long-term borrowing, subject to approval by the Legislature and a majority of voters at a general election. In addition, debt may be incurred without voter approval for the purpose of providing loans to school districts. General obligation notes to provide temporary financing for such loans are recorded as liabilities in the School Bond Loan Fund, a special revenue fund. General Fund appropriations are made to finance debt principal and interest requirements for all general obligation issues. General obligation bonds are backed by the full faith and credit of the State.

The State Constitution provides that the Legislature may also authorize the issuance of general obligation short-term notes, the principal amount of which may not exceed 15% of undedicated revenues received in the preceding year. The State Constitution also provides that such notes must be repaid within the fiscal year of the borrowing. In fiscal year 2003-2004, the State issued general obligation notes to meet cash flow requirements of the General Fund.

Short-term debt activity for the fiscal year ended September 30, 2004, was as follows (in billions):

	Beginning Balance	Draws	Repayments	Ending Balance
General Obligation Notes	$ -	$ 1.3	$ 1.3	$ -

Revenue Dedicated Bonds and Notes

Long-term bonds have been issued periodically for specific purposes, with the stipulation that financing of debt requirements is to come strictly from designated revenue sources. The transportation related debt is payable solely out of funds restricted for transportation purposes by Article 9, Section 9, of the State Constitution. The State's general credit does not support such issues.

In previous years, the Department of Transportation issued grant anticipation notes. The notes have variable rates that may bear interest at a daily interest rate, a weekly rate, note interest term rate, long-term interest rate, or an ARS interest rate.

The notes are issued in accordance with the authorization provided in P.A. 51 of 1951, as amended. The proceeds of the sale of the notes, together with investment earnings on the proceeds and other available monies, will be used to pay a portion of the costs to complete the Build Michigan II highway program, to pay capitalized interest on the notes, and to pay note issuance costs.

The principal and interest on the notes are payable solely from and are secured by an irrevocable pledge of the State share of all federal grants received each year under the Federal-Aid Highway Program. Payment of the principal and interest on the notes from the State share shall be subject to an appropriation each year by the Legislature in an amount sufficient to make the payments. As of September 30, 2004, there were no principal payments made on the notes. The amount outstanding at September 30, 2004, $600.0 million, is not disclosed in the table below.

The Michigan Underground Storage Tank Financial Assurance Finance Authority issued revenue bonds to provide financing for the activities of the Michigan Underground Storage Tank Financial Assurance Fund (MUSTFA). The bonds and notes are a limited obligation of the Authority payable solely from dedicated revenues and do not represent a general obligation of the finance authority or the State.

Revenue bonds have been issued by the State Building Authority (SBA) to acquire and/or construct various facilities for use by the State or institutions of higher education. Revenue bonds have also been issued to finance equipment capital lease refinancings and acquisitions. In addition, the SBA issues commercial paper notes to fund capital projects prior to bonding. Short-term debt activity for the fiscal year ended September 30, 2004, follows (in millions):

	Beginning Balance	Draws	Repayments	Ending Balance
Commercial Paper Notes	$ 338.5	$ 2,302.5	$ 2,191.8	$ 449.2

Note 13 provides disclosures regarding the bonds and notes payable of the discretely presented component units.

Bonds Issued and Outstanding

General obligation and revenue dedicated bonds issued and outstanding (excluding defeased bonds) at September 30 (in millions) are as follows:

			Fiscal Year Maturities		
General Obligation Bonded Debt	Amounts Issued	Outstanding 9/30/2004	First Year	Last Year	Average Interest Rate Percentage
General Obligation Refunding Debt:					
Series 2001 (Refunding)	$ 183.3	$ 183.0	2002	2016	4.76
Series 2002 (Refunding)	300.7	300.4	2004	2017	4.40
Recreation and Environmental Protection:					
Series 1989 (1)	75.0	21.3	1991	2012	6.92
Series 1992 (1)	246.3	86.4	1994	2013	6.15
College Savings Bonds - Series 1992 Mini-bonds (1)	.5	1.0	2012	2012	6.50
Series 1992 A (1)(2)	13.9	7.3	1994	2012	6.17
Series 1993 (1)(2)	16.7	10.1	1995	2013	5.00
Series 1995 (1)	234.3	83.9	1997	2020	5.28
Series 1998 (1)	90.0	19.9	1999	2009	4.80
Series 1999 A (3)	81.8	22.4	2004	2010	5.57
Series 2000 (1)	60.0	16.9	2002	2011	5.22
Series 2001 (3)	56.8	54.9	2004	2020	4.82
Series 2003 (5)	10.0	10.0	2053	2053	0.00
Series 2003 A (1)(3)	200.0	200.0	2007	2021	5.00
Series 2004 A (3)(4)	39.4	39.4	2010	2025	variable
Series 2004 B (3)(4)	15.1	15.1	2006	2010	variable

School Loan Bonds:					
Series 1995	180.0	24.9	1997	2007	5.47
Series 1998	160.0	65.7	2001	2012	4.86
Series 2001 C (4)	45.9	45.9	2019	2021	variable
Series 2002 A (4)	50.6	31.0	2005	2019	variable
Series 2002 B (4)	47.3	46.5	2018	2021	variable
Series 2003 B (4)	3.3	3.3	2008	2010	variable
Series 2004 A (4)	203.2	203.2	2020	2024	variable
Series 2004 B (4)	35.1	35.1	2020	2024	variable
Total General Obligation Bonded Debt	2,349.0	1,527.5			
Revenue Dedicated Bonded Debt					
MUSTFA Related:					
Tax Dedicated Bonds:					
1996 - Revenue Bonds - Series I	216.6	104.8	1997	2010	5.67
State Park Related:					
2002 - Gross revenue Bonds	15.5	15.0	2004	2023	3.58
Total Revenue Dedicated Bonded Debt - MUSTFA and State Park Related	232.1	119.8			
Transportation Related:					
Tax Dedicated Bonds:					
Michigan Comprehensive Transportation:					
Series 1996 (Series A Refunding)	22.7	20.2	1998	2014	5.42
Series 1998 (Series A Refunding)	38.6	38.6	2005	2011	4.66
Series 2001 (Series A Refunding)	27.8	27.8	2008	2022	5.01
Series 2002 (Series A Refunding)	89.6	67.9	2003	2011	5.06
Series 2002 (Series B)	82.3	79.6	2004	2022	5.13
Series 2003	35.0	33.5	2004	2023	3.61
State Trunkline Fund Bonds:					
Series 1989 (Series A)	135.8	24.6	1994	2009	6.97
Series 1992 (Series A Refunding)	253.6	63.7	2000	2013	5.64
Series 1992 (Series B Refunding)	99.6	9.8	2000	2013	5.68
Series 1994 (Series A Refunding)	150.0	3.3	1996	2006	5.50
Series 1996 (Series A)	54.5	3.4	1998	2008	5.71
Series 1998 (Series A)	377.9	377.9	2006	2027	5.09
Series 2001 (Series A)	308.2	197.8	2003	2031	5.27
Series 2002 (Refunding)	97.9	86.0	2004	2022	4.71
Series 2004 (Refunding)	103.5	103.5	2006	2022	4.13
Series 2004	185.7	185.7	2008	2019	4.36
Total Revenue Dedicated Bonded Debt - Transportation Related	2,062.7	1,323.3			

	Amounts Issued	Outstanding 9/30/2004	Fiscal Year Maturities First Year	Fiscal Year Maturities Last Year	Average Interest Rate Percentage
State Building Authority:					
1998 Series I Bonds (Refunding)	330.4	284.1	1999	2021	4.75
1999 Series I Bonds	85.7	66.5	1999	2016	4.54
2000 Series I Bonds	147.9	134.3	2000	2022	5.24
2001 Series I Bonds	121.7	108.6	2002	2019	5.28
2001 Series I Bonds (Refunding)	419.7	398.5	2003	2026	5.31
2001 Series II Bonds	170.1	157.3	2003	2020	5.28
2002 Series III Refunding	215.2	210.7	2004	2027	4.60
2003 Series I Refunding	659.4	636.7	2004	2018	3.64
2003 Series II Refunding	392.6	392.6	2005	2030	4.42
2004 Series I	155.4	155.4	2005	2020	4.08
Total State Building Authority Bonded Debt	2,698.0	2,544.6			
Total Revenue Dedicated Bonded Debt	4,992.7	3,987.7			
Total General Obligation and Revenue Dedicated Bonded Debt	$ 7,341.8	$ 5,515.2			

(1) Public Acts 326 and 327 of 1988 and P.A. 451 of 1994 authorized the issuance of bonds totaling $800.0 million. As of September 30, 2004, $774.6 million of such bonds had been issued, leaving remaining authorization of $25.4 million. Sum of amounts issued in table differs by amount of bonds refunded or redeemed.

(2) The $13.9 million Series 1992A and the $16.7 million Series 1993, Recreation and Environmental Protection General Obligation Bonds, were used to provide a contribution of capital to the Michigan Municipal Bond Authority (a discretely presented component unit). An outside trustee for the Authority is holding the bonds as an investment of the Authority; no immediate cash proceeds were provided. The trustee receives the debt service payments on the bonds, which are negotiable instruments held to subsidize water pollution control financing provided by the Authority.

(3) Public Act 284 of 1998 authorized the issuance of bonds totaling $675.0 million. As of September 30, 2004, $331.2 million of such bonds had been issued, leaving remaining authorization of $343.8 million. Sum of amounts issued in table differs by amount of bonds refunded or redeemed.

(4) The Multi-Modal Series, Environmental and School Loan Bond Series, currently bear interest at a commercial paper rate and are remarketed at each maturity. For the future debt service requirements, interest was estimated at the interest rate in effect at September 30, 2004.

(5) In November 2002, voters approved a ballot proposal in which the State would issue $1.0 billion in general obligations bonds to provide capital, which is then loaned to local units of government for water quality improvement projects. Rather than issuing the bonds at public or private sale and receiving cash, the State "issued" $100.0 million in bonds to a discretely presented component unit, the Michigan Municipal Bond Authority (MMBA). Although no cash traded hands, MMBA (the registered owner of the bonds) is holding the bond document as collateral and issuing their own revenue bonds to generate the capital. This transaction allows the State's General Fund to defer principal and interest costs until future years when the bond is repurchased/redeemed. MMBA will fund the principal and interest costs of the revenue bonds until such time that they request the State to honor the general obligation bond document.

On December 18, 2003, the State issued $100.0 million in bonds ($10.0 million relating to Strategic Water Quality and $90.0 million relating to the previously existing State Water Quality Revolving Fund). The $10.0 million bond relating to Strategic Water Quality includes a repurchase provision that requires the State to repurchase all or any portion of this bond upon 10 days prior written notice from the registered owner, MMBA. The State anticipates at this time that if the bond repurchase was acted on, the State would issue long-term debt to finance the repurchase. This bond is being used as collateral by MMBA for the Strategic Water Quality bonds being issued by MMBA to local governments. For these reasons, the State has recognized the $10.0 million bond related to Strategic Water Quality as a liability in the entity-wide statements. The $90.0 million "bond" document issued for the State Water Quality Revolving Fund does not contain the 10 day repurchase provision that the $10.0 million bond does. Nor is the $90.0 million "bond" document being used as collateral by MMBA. For these reasons, the State has not recognized a liability for the $90.0 million "bond" document related to the existing State Water Quality Revolving Fund.

Capital Appreciation Bonds

Capital appreciation and convertible capital appreciation bonds are recorded in the preceding table and Section B at their accreted year-end book value. The table that follows summarizes capital appreciation bonds (in millions):

	Accreted Book Value	Ultimate Maturity Value	Fiscal Year Maturities First Year	Fiscal Year Maturities Last Year
General Obligation Bonds:				
Series 1989	$28.5	34.3	1999	2012
Series 1992	16.7	22.1	1994	2012
College Savings Bonds - Series 1992 Mini-bonds	1.0	1.8	2012	2012
Series 1995	15.9	19.7	2001	2010
Revenue Dedicated – Transportation Related:				
State Trunkline – Series 1989 A	24.6	29.8	2004	2009
State Trunkline – Series 1992 A and B	73.5	97.7	2006	2013

Refundings and Defeasances

The State has defeased certain bonds through advance refundings by placing the proceeds of new bonds (i.e., the "refunding" bonds in the table of bonds issued and outstanding) in irrevocable trust to provide for all future debt service on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not recorded as assets or liabilities in these statements and are not included in the other debt tables in this note.

The State has defeased certain bonds through current refundings in which the proceeds of the refunding debt are applied immediately to redeem the debt to be refunded.

The following table summarizes the defeased bonds outstanding at September 30 (in millions):

	Amounts Outstanding
Recreation and Environmental Protection:	
Series 1989	$ 2.5
Series 1995	103.1
Series 1998	50.4
Series 1999 A	56.1
Series 2000 (partial)	37.4
Total	$ 249.4
School Loan Bonds:	
Series 1995	$ 103.3
Series 1998	69.1
Total	$ 172.4
State Trunkline Fund Bonds:	
Series 1994 A (partial)	$ 123.8
Series 1996 A (partial)	45.2
Series 2001 A (partial)	99.3
	$ 268.3
State Building Authority:	
1989 Series I	$ 10.8
1993 Series I	37.0
1994 Series I	18.2
1994 Series II	13.8
1996 Series I	51.8
1997 Series I	81.0
1997 Series II	264.0
1998 Series I	81.0
1997 Series A	10.9
2000 (MSP Phase II)	35.1
2001 (MSP Phase III)	49.2
2002 (MSP Phase IV)	32.7
Total	$ 685.6

General Obligation

During the year, the State of Michigan issued, as a current refunding, $238.3 million of School Loan Multi-Modal Bonds Series 2004 A & B maturing in years 2020 through 2024 with a variable interest rate. The maximum interest rate applicable to the Series 2004A bonds is 10% annually and the maximum interest rate applicable to the

Series 2004B bonds is 12% annually. From the proceeds, $141.8 million was used to refund principal and interest on General Obligation bonds and School Loan Bonds, $96.5 million was deposited into the School Bond Loan Fund to make loans to local school districts and to pay for costs of issuance of the bonds.
Also during the year, the State of Michigan issued, as a current refunding, $51.0 million of School Loan Multi-Modal Bonds Series 2003 D & E maturing in years 2017 through 2021 with a variable interest rate. The maximum interest rate applicable to the Series 2003 D & E bonds is 12% annually. From the proceeds, $4.7 million was used to refund principal and interest on General Obligation bonds and School Loan Bonds, $24.0 million was deposited into the School Bond Loan Fund to make loans to local school districts, $22.4 million was used to make regularly scheduled principal and interest payments and to pay for costs of issuance of the bonds. These bonds were issued and completely refunded in fiscal year 2004 with the proceeds of School Loan Multi-Modal Bonds Series 2004 A & B.

The variable rate refunded and new debt bear interest rates based upon various periodic market rates and are remarketed at each maturity.

Revenue Dedicated

In May of 2004, the State issued $103.5 million of revenue dedicated State Trunk Line Fund Refunding Bonds Series 2004. The proceeds were used to refund various portions of previously issued bonds that carried higher interest rates.

The State advance refunded these bonds to reduce its total debt service payments over the next 18 years by $5.4 million and to achieve an economic gain of $3.9 million.
During the year, the State Building Authority issued $303.5 million of fixed-rate revenue refunding bonds (as part of a total issuance of $392.6 million, which provided $89.1 million of financing for new projects), along with $13.2 million of Authority cash and $15.8 million of issuance premium, for a current refunding of $332.5 of variable-rate revenue bonds. The refunding was undertaken to reduce future debt service payments and to lock-in favorable interest rates. The refunded variable-rate bonds had no stated annual debt service requirements, had a nominal final maturity date of October 15, 2037, and bore interest at a commercial paper rate. The refunded bonds, which serially mature through October 15, 2029, carry an average fixed interest rate of 4.415%.

Also during the year, the State Building Authority (SBA) issued $112.8 million of revenue refunding bonds (as part of a total issuance of $155.4 million). The proceeds were used to provide resources to purchase U.S. Government securities that were placed in an irrevocable trust along with $16.8 million of Authority cash for the purpose of generating resources for all future debt service payments of $127.9 million of bonds.

The advance refunding was undertaken to reduce total debt service payments by $2.8 million and resulted in an economic gain of $1.3 million.

Debt Service Requirements

The following table summarizes debt service requirements for outstanding bonds (in millions):

	General Obligation			MUSTFA, State Park, and Transportation Related		State Building Authority		Total
Fiscal Years Ending	Principal	Fixed Interest	*Estimated Interest	Principal	Fixed Interest	Principal	Interest	Principal And Interest
2005	$ 56.0	$ 53.3	$ 5.1	$ 65.0	$ 67.7	$ 78.8	$ 126.1	$ 452.0
2006	61.9	50.7	5.1	68.4	65.1	108.4	122.5	482.1
2007	78.1	48.0	5.1	71.0	62.4	113.2	117.9	495.6
2008	82.5	44.8	5.0	85.9	59.5	118.5	112.2	508.4
2009	86.1	41.4	5.0	89.3	56.1	124.1	106.3	508.2
2010-2014	480.5	144.5	23.7	339.7	232.7	722.0	426.9	2,370.0
2015-2019	336.0	36.7	22.1	359.5	151.2	718.3	224.4	1,848.1
2020-2024	348.8	3.0	10.1	253.6	63.1	364.7	91.1	1,134.4
2025-2029	3.3	-	-	101.4	22.2	175.4	23.6	326.0
2030-2034	-	-	-	38.7	2.1	21.3	.5	62.6
2035-2039	-	-	-	-	-	-	-	-
Thereafter	10.0	-	-	-	-	-	-	10.0
Total	$1,543.2	$ 422.4	$ 81.2	$1,472.5	$ 782.1	$2,544.6	$1,351.5	$ 8,197.5

*Interest for Multi-Modal Bonds future debt service requirements was estimated at the rate in effect at September 30, 2004.

Interest to maturity for the State Building Authority will be significantly smaller than the amount shown in the above table because many of the bonds will be called prior to the final scheduled maturity date. The retirement of these bonds varies from project to project, as each bond issue is related to specific projects and any excess borrowing and accrued investment earnings are restricted to projects and debt service on the related bonds. State Building Authority debt service fund unreserved fund balances totaled $193.5 million at year-end. Most of this represents investments related to completed projects that will be used for debt service on the projects' bonds.

Some of the bonds of the State Building Authority carry variable interest rates and interest on these has been projected using an average interest rate.

B. Changes in Bonds and Notes Payable

Changes in bonds and notes payable for the year ended September 30, 2004, are summarized as follows (in millions):

Governmental Activities	Beginning Balance Restated*	Additions	Reductions	Ending Balance	Amounts Due Within One Year	Amounts Due Thereafter
Bonds Payable:						
General obligation debt	$ 1,413.4	$ 357.2	$ 243.1	$ 1,527.5	$ 56.0	$ 1,471.5
Revenue bonds	1,312.8	295.2	164.9	1,443.1	65.0	1,378.1
State Building Authority	2,569.7	547.9	573.1	2,544.6	78.8	2,465.8
Notes Payable:						
Transportation related	600.0	-	-	600.0	-	600.0
Deferred Loss on Refundings:						
General obligation debt	(30.0)	-	2.3	(27.7)	-	(27.7)
Revenue dedicated debt	(5.5)	(8.3)	.6	(13.2)	-	(13.2)
State Building Authority	(56.3)	(6.0)	5.5	(56.9)	-	(56.9)
Unamortized Premiums:						
General obligation debt	53.0	-	4.1	48.9	-	48.9
Revenue dedicated debt	23.2	25.3	2.2	46.2	-	46.2
State Building Authority	107.3	30.7	7.9	130.1	-	130.1
Total bonds and notes payable	$ 5,987.6	$ 1,242.0	$ 958.4	$ 6,242.7	$ 199.8	$ 6,043.0
Plus commercial paper notes reported as "Current Liabilities: Bonds and notes payable" on the Statement of Net Assets				449.2	449.2	-
As reported on the Statement of Net Assets				$ 6,691.9	$ 648.9	$ 6,043.0

*The beginning balance of long-term debt outstanding as presented above and deferred amounts on refunding were each reduced by $37.0 million because of the reclassification of prior year debt refunding for the State Building Authority.